M E M O R A N D U M

TO: Missouri Public Service Commission Official Case,
Case No.GR-2020-0126, Liberty Utilities (Midstates Natural Gas) Corp.

FROM: David M. Sommerer, Regulatory Compliance Manager, Procurement Analysis
Kwang Y. Choe, PhD, Regulatory Economist, Procurement Analysis
Keenan B. Patterson, PE, Regulatory Engineer, Procurement Analysis

/s/ David M. Sommerer 12/14/2020 — Project Coordinator / Date
/s/ Karen Bretz 12/14/2020 — Staff Counsel's Office / Date

SUBJECT: Staff Recommendation in Case GR-2020-0126, Liberty Utilities (Midstates Natural Gas) Corp. 2018-2019 Actual Cost Adjustment Filing

DATE: December 14, 2020

Procurement Analysis Staff reviewed Liberty Utilities (Midstates Natural Gas) Corp., d/b/a Liberty Utilities' ("Liberty" or "Company") 2018-2019 Actual Cost Adjustment (ACA) filing. This filing was made on November 4, 2019 for rates to become effective on December 4, 2019 in all areas Liberty serves in Missouri. This filing was docketed as Case No. GR-2020-0126.

This memorandum is organized into four sections. Each section contains detailed explanations of Staff's concerns and recommendations. The four sections are:

Section No.	Topic	Page
I	Billed Revenue and Actual Gas Costs	2
II	Reliability Analysis and Gas Supply Planning	3
III	Hedging	5
IV	Recommendations	7

Staff's analysis consisted of:

1. A review and evaluation of the Company's billed revenues and its natural gas costs for the period of September 1, 2018 to August 31, 2019. A comparison of billed revenue recovery with actual costs will yield either an over-recovery or under-recovery of the ACA costs.
2. A reliability analysis of the Company's estimated peak day requirements and capacity levels to meet those requirements.

** Denotes Confidential Information **

Appendix A

3. An examination of the Company's gas purchasing practices to determine the prudence of the Company's purchasing decisions.

4. A hedging review to determine the reasonableness of the Company's hedging plans for this ACA period.

<u>Liberty's Missouri service territory</u>

Liberty's systems in Missouri are grouped into three geographic areas: Northeast, Southeast and West. For gas cost recovery, there are four PGA/ACA rate divisions, three of which are made up of the three geographic divisions. A fourth PGA division, Kirksville, is separate from the Northeast area. A more detailed description, with the associated interstate pipelines serving these areas, follows:

> The West area (WEMO) includes Butler, which is served by Panhandle Eastern Pipe Line Company (PEPL), and Stateline (also known as Rich-Hill/Hume), which is served by Southern Star Central Gas Pipeline, Inc. (SSCGP). The West area serves an average of 4,097 firm sales customers.
>
> The Northeast area (NEMO) includes Hannibal-Canton, Bowling Green, and Palmyra served by PEPL. The NEMO area serves an average of 13,879 firm sales customers.
>
> The Kirksville area, served by ANR Pipeline Company (ANR), serves an average of 5,631 firm sales customers.
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> The Southeast area (SEMO) includes Jackson, served by Natural Gas Pipeline Co. of America (NGPL); Piedmont, served by Mississippi River Transmission Corp. (MRT); and the Southeast Missouri Integrated system, served by Texas Eastern Transmission, LP (TETCO) and Ozark Gas Transmission, LLC. The Southeast area also includes the former Neelyville/Quilin service area. Together they serve an average of 33,477 firm sales customers.

The total customer count for all divisions is an average of 57,084 firm sales customers.

STAFF TECHNICAL REPORT AND ANALYSIS

I. BILLED REVENUE AND ACTUAL GAS COSTS

Staff reviewed billed revenue and actual gas cost filed for the period ending August 31, 2019.

Staff proposes no prudence disallowances or compliance adjustments related to this section of

Staff's recommendation for this ACA period.

However, Staff noted relatively large ACA balances in some of the Company's service areas, in this period, the SEMO and Kirksville areas. These large balances are the result of significant differences between billed revenue and the actual gas cost incurred. Estimates of purchases and sales that are not consistent with actual experience can create a tendency to over or under collect gas costs. Another possible explanation for large over or under collections of gas costs is when the estimate for gas costs no longer represents the current market rates. In this ACA period, the Company substantially over-collected from its customers for the SEMO and Kirksville PGA service areas.

The use of an optional additional PGA filing, which is allowed for local distribution companies (LDCs), might mitigate the rate volatility that has been experienced in some of the Company's service areas and prevent significant over-collection from customers as occurred during this ACA period. Staff recommends the Company closely evaluate the purchases and sales estimates used to establish PGA and ACA rates, and monitor the level of ACA balances throughout the year. Staff also recommends that in future ACA filings, the Company describe the causes of its over and under collections.

II. RELIABILITY ANALYSIS AND GAS SUPPLY PLANNING

As a regulated gas corporation providing natural gas services to Missouri customers, a LDC is responsible for conducting reasonable long-range supply planning and for the decisions resulting from that planning. A purpose of the ACA process is to review the LDC's planning for gas supply, transportation and storage to meet its customers' needs. For this analysis, Staff reviewed Liberty's plans and decisions regarding estimated peak day requirements and the capacity levels to meet those requirements, peak day reserve margin and the rationale for this margin and natural gas plans for various conditions.

Staff has no proposed financial adjustments for the 2018-2019 ACA period related to reliability analysis and gas supply planning. Staff's other comments and recommendations are discussed in the rest of this section.

<u>Reserve Margins</u>

As part of its planning process, Liberty calculated reserve margins in its service areas. ** ____

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Transportation Customers and School Aggregation

Staff compared the monthly imbalances of school aggregation pools to those of other transportation customers. The distribution of imbalances for these two types of transportation customers during the 2018-2019 ACA period is shown in the following graph. School pools tend to be less in balance than firm transportation pools. ** **

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Staff also compared the average unit price of cash outs that Liberty paid to transportation customer to the average unit price it charged them to address imbalances. ** ** If the utility does not fully recover the cost of imbalances associated with transportation customers from those customers, the cost is passed to all other sale customers through the PGA.

In light of these facts, Staff recommends that Liberty review its school aggregation provisions to assure that they properly incentivize school aggregation pool operators to balance use and deliveries. For instance, Liberty balances non-school transportation customers on a daily basis, though it is not presently equipped for daily balancing of school pools. Non-school transportation customers have greater multipliers applied to prices charged for larger imbalances. These provisions create stronger disincentives for imbalances of non-school transportation customers than those faced by school aggregation pools.

III. HEDGING

A few definitions that may assist the hedging discussion are as follows. A "swap" is an instrument that fixes the price of gas for a certain volume of gas. Therefore, the price is no longer "variable" as with an index-based contract, but is fixed. A "call option" is a financial instrument that gives the buyer the right but not the obligation to buy gas at a certain preset fixed price. That fixed price is often higher than the current market, and essentially provides a cap on the gas price, albeit at the price of paying a premium. A "physical hedge" is a feature of using an actual gas supply contract to limit exposure to price increases rather than using financial instruments (swaps, futures, calls) that offset the price risk independently and separately from the gas supply itself.

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Staff reviews the prudence of a company's hedging decision-making based on what the

[1] Liberty received hedging advice for its financial hedging transactions from a consulting firm, Gelber and Associates, during this ACA period.

company reasonably knew, or reasonably could have known, at the time it made its hedging decisions. Part of a company's hedging planning should be flexible, in part, to incorporate changing market circumstances to balance the cost of hedging against the goal of price stabilization, and thus to achieve a cost effective hedging outcome. For example, a company should continue to evaluate whether utilization of swaps and the volumes associated with them are appropriate under current market conditions where the market prices have become less volatile. Staff noted that Liberty has improved in its hedge planning practices with its consideration of additional financial instruments in addition to swaps.[2]

Staff recommends the Company continually monitor and be aware of any significant changes in natural gas supply and demand fundamentals over time.

Staff also recommends the Company continue to assess and document the effectiveness of its hedges for the 2019-2020 ACA and beyond. The analysis should include, but not be limited to, whether the hedging implementation was consistent with the hedging plan, identifying the benefits/costs based on the outcomes from the hedging strategy, and thus evaluating any potential improvements on the future hedging plan and its implementation. Additionally, Staff recommends the Company evaluate whether the hedging plan for each of the four systems has operational implications for warm and cold weather conditions. Finally, Staff recommends the Company continue to monitor the market movements diligently, employ *disciplined* (triggered primarily by the passage of time) as well as *discretionary* (hedge decisions influenced by the Company's view of favorable pricing environments) approaches in its hedging practices, ** ________ . **

An example of a physical hedge would be a fixed price gas supply contract.

The following table provides a summary, by service area, of how much gas was hedged as a percentage of normal required winter volumes:

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There is no financial adjustment related to hedging.

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IV. RECOMMENDATIONS

Staff recommends that the Commission issue an order requiring Liberty to:

1. Incorporate the (over)/under-recovered ending ACA balances in Staff's Proposed Balances 8/31/19 column of the following table:

All Areas:	Company Filed Balance 8/31/19	Staff Adjustments	Staff Proposed Balances 8/31/19
SEMO Area			
Demand ACA	$ 291,688	$ 0	$ 291,688
Commodity ACA	$ (3,103,075)	$ 0	$ (3,103,075)
Kirksville Area			
Demand ACA	$ (139,084)	$ 0	$ (139,084)
Commodity ACA	$ (1,249,026)	$ 0	$ (1,249,026)
WEMO Area			
Demand ACA	$ (3,003)	$ 0	$ (3,003)
Commodity ACA	$ 220,453	$ 0	$ 220,453
NEMO Area			
Demand ACA	$ (570,936)	$ 0	$ (570,936)
Commodity ACA	$ (679,996)	$ 0	$ (679,996)

A positive ACA balance indicates an under-collection that must be recovered from customers.
A negative ACA balance indicates an over-recovery that must be returned to customers.

2. Respond to all Staff recommendations for Section I, Billed Revenue and Actual Gas Costs; Section II, Reliability Analysis and Gas Supply Planning; and Section III, Hedging.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Liberty Utilities (Midstates Natural Gas) Corp, d/b/a Liberty Utilities' Purchased Gas Adjustment Tariff Filing	)))	**File No. GR-2020-0126**

AFFIDAVIT OF DAVID M. SOMMERER, KWANG Y. CHOE, PHD, AND KEENAN B. PATTERSON, PE

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

COME NOW David M. Sommerer, Kwang Y. Choe, PhD, and Keenan B. Patterson, PE and on their oath declare that they are of sound mind and lawful age; that they contributed to the foregoing *Staff Recommendation* in memorandum form; and that the same is true and correct according to their best knowledge and belief, under penalty of perjury.

Further your Affiants sayeth not.

/s/ *David M. Sommerer*
David M. Sommerer

/s/ *Kwang Y. Choe, PhD*
Kwang Y. Choe, PhD

/s/ *Keenan B. Patterson, PE*
Keenan B. Patterson, PE